

PAUL B. SNYDER
United States Bankruptcy Judge
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MARK L. HATCHER
CLERK U.S. BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA

DEPUTY

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA**

In re:

RONNIE L. REGISTER
CARRIE L. REGISTER,

Debtors.

HIGHLINE CAPITAL CORPORATION,

Plaintiff,

v.

RONNIE L. REGISTER
CARRIE L. REGISTER,

Defendants.

Case No. 08-44241

Adversary No. 08-04138

MEMORANDUM DECISION

NOT FOR PUBLICATION

Trial was held in this matter on January 6, 2010, with closing arguments held on January 22, 2010. Plaintiff Highline Capital Corporation (Highline), in accordance with its complaint, seeks to have the debt owed by Defendants Ronnie and Carrie Register (Debtors) declared nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(B). At the conclusion of the trial, the Court took the matter under advisement. This Memorandum Decision shall constitute Findings of Fact and Conclusions of Law as required by Fed. R. Bankr. P. 7052.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

In November, 2004, Debtor Ronnie Register left his employment with Taco Time. On December 9, 2004, the Debtors completed a franchise application to open a Figaro's Pizza restaurant

1 in Battle Ground, Washington. On December 30, 2004, the Debtors paid \$34,500 in franchise fees to
2 Figaro's Italian Pizza, Inc. (Figaro's). Figaro's provided the Debtors with a list of potential financial
3 lenders for business loans. From this list, the Debtors contacted Gary Barnett (Barnett) of Emerald
4 Commercial for the purpose of obtaining a business loan to purchase the assets necessary to operate
5 the franchise pizza business.

6 On January 19, 2005, the Debtors entered into a residential real estate purchase and sale
7 agreement for the purchase of a new home to be constructed in Battle Ground. The residential
8 contract was for a purchase price of \$237,255 and conditioned on the sale of the Debtors' current
9 home in Sedro Wooley, Washington.

10 On January 29, 2005, the Debtors personally completed a handwritten application for franchise
11 financing and financial statement that was submitted to Barnett. This financial statement listed a joint
12 annual income of \$78,800 for the year ending 2003, and a net worth of \$150,000. On February 5,
13 2005, the Debtors completed a revised personal financial statement. This handwritten financial
14 statement also indicated a net worth of \$150,000. Each of these financial statements listed real estate
15 with a value of \$157,000 and mortgage balance of \$79,000, with payments of approximately \$1,182
16 per month.

17 Barnett subsequently prepared a typed financial statement for the Debtors dated February 5,
18 2005, indicating a total net worth for the Debtors of \$211,432. The difference between the two
19 February 5th financial statements is an increase in the amount held in checking from \$2,000 on the
20 handwritten statement, to \$58,000 on the typed statement and the addition of \$5,232 for the cash
21 surrender value-life-insurance. This loan was denied, although the Debtors testified that the denial
22 was never communicated to them.

23 On February 11, 2005, the Debtors sold their home in Sedro Wooley, and moved into the home
24 of Carrie Register's parents located in Longview, Washington. On February 14, 2005, the Debtors
25 paid an additional earnest money deposit of \$4,200 for the Battle Ground home and removed the
contingency regarding the sale of their home in Sedro Wooley.

1 On March 17, 2005, the Debtors filed a certificate of incorporation for RCRBG Corp, the entity
2 through which they would be operating their Figaro's Pizza franchise. On April 29, 2005, Ronnie
3 Register's father passed away in the State of Florida.

4 In March, 2005, the Debtors allege that Barnett orally informed them that their business
5 financing had been approved. This testimony is supported by the fact that on April 6, 2005, the
6 Debtors paid a deposit for business equipment. A bill of sale was signed to transfer the equipment for
7 a price of \$37,000. In April, 2005, the Debtors executed a Lease Agreement at Padden Parkway
8 Market Center for their Figaro's franchise. A deposit of \$5,531 was paid to the landlord on April 13,
9 2005. A personal guaranty of the lease obligation was also executed at that time.

10 On June 6, 2005, the Debtors executed an updated financial statement (June 2005 Financial
11 Statement) prepared by Barnett. The June 2005 Financial Statement deleted any reference to real
12 estate owned and real estate mortgages payable. Listed under the line entry for "Accounts, loans &
13 notes receivable" was the sum of \$280,000, followed by an asterisk, without further explanation.
14 Presumably this referenced the expected inheritance from Mr. Register's father. The June 2005
15 Financial Statement listed annual income of \$80,000.

16 On June 9, 2005, Barnett sent a fax to Americorp Financial, LLC, requesting that the loan
17 amount request be increased from \$150,000 to \$160,000. The fax coversheet also advised that the
18 Debtors had sold their home in Sedro Wooley and were currently renting a home from Ronnie
19 Register's parents for \$500 per month, and that Mr. Register was to receive an inheritance of
20 \$280,000 from his father within 30 days. Highline asserts that the loan was approved on June 13,
21 2005. On June 28, 2005, a finance agreement was entered into between Americorp Financial, LLC,
22 as lender, and RCRBG Corp, as borrower, for the principal amount of \$149,439.88. On that same
23 date, the Debtors executed a personal guaranty for the business loan.

24 On August 24, 2005, the Debtors closed on the purchase of the new home in Battle Ground for
25 a purchase price of \$301,905.91. On September 2, 2005, Americorp Financial, LLC, assigned the
business loan and personal guaranty to Highline for the sum of \$153,901.21.

1 On June 15, 2005, the Debtors made an initial down payment on the loan of \$5,284.17.
2 Through June, 2008, the Debtors made seven payments of \$1,400 per month, six payments of \$1,900
3 per month, 21 payments of \$3,034.17, and three payments of \$1,820.50, for a total of \$95,663.24.
4 The Debtor's Figaro's Pizza franchise closed on July 12, 2008.

5 The Debtors filed a Chapter 7 bankruptcy petition on August 27, 2008. On November 24,
6 2008, Highline filed a complaint objecting to the Debtors' discharge under § 523(a)(2) and § 727(a)(4).
7 At the commencement of trial, Highline indicated that it was not pursuing the § 727(a)(4) claim. As no
8 evidence was presented to support the § 727(a)(4) claim, the Court concludes that it should be denied.

9 11 U.S.C. § 523(a)(2)(B) excepts from discharge a debt for money, property, services or credit
10 to the extent obtained by

11 (B) use of a statement in writing –

12 (i) that is materially false;

13 (ii) respecting the debtor's or an insider's financial condition;

14 (iii) on which the creditor to whom the debtor is liable for such money, property,
services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive.

15 A creditor must prove the elements of § 523(a)(2)(B) by a preponderance of the evidence.
16 Grogan v. Garner, 498 U.S. 279, 291 (1991).

17 The Debtors do not appear to dispute that the debt at issue was obtained by use of a statement
18 in writing (the June 2005 Financial Statement), that contained representations of fact regarding their
19 financial condition, and that they are insiders of the corporation. In closing, the Debtors' counsel
20 indicated that the issues in dispute are only whether Highline has established by the preponderance of
21 the evidence that the representations were made by the Debtors with the requisite intent to deceive
22 upon which Highline reasonably relied.

23 A. Intent to Deceive

24 Under § 523(a)(2)(B), "fraudulent misrepresentation is established by showing 'either actual
25 knowledge of the falsity of a statement, or reckless disregard for its truth . . .'" Gertsch v. Johnson &
Johnson, Finance Corp. (In re Gertsch), 237 B.R. 160, 167 (9th Cir. BAP 1999) (quoting Houtman v.

1 Mann (In re Houtman), 568 F.2d 651, 656 (9th Cir. 1978), overruled on other grounds by Grogan, 498
2 U.S. at 284-85 n.11)). Thus, intent to deceive can be inferred from the totality of the circumstances,
3 including reckless disregard for the truth. Gertsch, 237 B.R. at 167-68.

4 As evidence of intent to deceive, Highline first argues that the Debtors knew they were not
5 presently earning \$80,000 per year when they executed the June 2005 Financial Statement. Ronnie
6 Register testified that he understood “annual income” to refer to their annual income for the last full
7 calendar year, or 2004, which the evidence supports as being approximately \$80,000. The Court finds
8 the Debtors’ explanation to be credible, particularly because the financial statement itself is
9 ambiguous. Section 4 is titled “Annual Income for Year Ended,” and the year is left blank. No
10 explanation was provided as to why the blank on the June 2005 Financial Statement prepared by
11 Barnett was not completed to specify the year upon which the annual income numbers were based.
12 As the Debtors first completed a financial statement in January, 2005, it was reasonable for them to
13 utilize their annual income from the last full calendar year. Although the Debtors should have revised
14 this figure on the June 2005 Financial Statement, particularly since Mr. Register was no longer
15 employed, the Debtors disclosed that Ronnie Register’s employment was to be operation of the pizza
16 restaurant in the Application for Franchise Financing prepared on January 29, 2005, and submitted to
17 Barnett for the purpose of obtaining financing. In this application, the Debtors also clearly disclosed
18 that only Carrie Register was to keep her existing employment with an annual income of \$48,800.

19 The Court finds that neither of the Debtors are sophisticated business persons. Although
20 Ronnie Register had experience with food service businesses, there is no evidence that he had any
21 experience in applying for a business loan. They were not represented by counsel. Moreover, the
22 handwritten financial statements prepared by the Debtors dated January 29, 2005 (Defendants’ Exhibit
23 13), and February 5, 2005 (Defendants’ Exhibit 17), indicate that the Debtors were relying on their
24 annual income for prior years.

25 The lease guaranty was not disclosed on the June 2005 Financial Statement, however, it is
clear from the string of emails submitted into evidence that Highline was aware of the lease as it

1 attempted to secure a landlord waiver prior to entering into the finance agreement. Highline needed to
2 only inquire of either the Debtors or the landlord as to whether it was guaranteed. Additionally, the
3 Debtors' testimony is credible that they did not understand that it should be listed as a "contingent
4 liability," negating any intent on their part to deceive.

5 Highline also alleges that the Debtors knew they were under a contract to purchase a new
6 home at the time the June 2005 Financial Statement was prepared and that this information should
7 have been disclosed. Ronnie Register testified that he informed Barnett of their intent to purchase a
8 new home and that Barnett advised them that this information did not need to be disclosed because
9 the sale had not yet closed and they currently had no existing mortgage debt. The Court finds the
10 Debtors' explanation credible, particularly as the financial statement itself could reasonably be
11 interpreted by an unsophisticated borrower to not require disclosure. Although the Debtors entered
12 into a contract for the purchase of the new home in January, 2005, the purchase did not close for
13 several months after the June 2005 Financial Statement was prepared. When completed, the June
14 2005 Financial Statement was technically accurate in that the Debtors did not own any real property
15 and had no mortgage indebtedness. While the home contract could be characterized as a contingent
16 liability, as indicated above, the Debtors were unsophisticated, unrepresented and did not understand
17 the term contingent liability. Their testimony that Barnett was aware of the home purchase, who they
18 believed was an agent of the lender, is also credible.

19 Contrary to the argument of Highline's counsel, the Court does not find the statement made in
20 Ronnie Register's deposition testimony that he did not "know if [he] told Gary or not" to be
21 contradictory. (Ronnie Register's deposition p.48, line 23). Ronnie Register testified that this
22 statement was made solely in response to a question asking whether he informed Barnett about the
23 closing of the home sale and ensuing mortgage in August, 2005. Based on the context of the series of
24 questions asked at that time, the Court finds Ronnie Register's explanation to be credible.

25 The Debtors maintain that throughout the loan process, they understood Barnett to be an agent
of the lender, not a broker shopping their loan. Although Barnett was not an agent of Highline, the

1 uncontradicted evidence indicates that Barnett held himself out as an agent of the original lender. As
2 an assignee, knowledge of the assignor would be imputed to Highline. See New Falls Corp. v.
3 Boyajian (In re Boyajian), 564 F.3d 1088, 1091 (9th Cir. 2009) (holding that an assignee steps into the
4 shoes of the assignor allowing it to bring a nondischargeability complaint).

5 The finance agreement entered into June 28, 2005, was between RCRBG Corp. as debtor, and
6 Americorp Financial, LLC., as the secured party. The same is true of the personal guaranty signed on
7 the same date. This finance agreement was assigned by Americorp Financial, LLC to Highline on
8 September 2, 2005. Subsequently, the Debtors received a letter dated September 22, 2005, from
9 Barnett as Vice President of Sales for Americorp Financial, LLC, thanking them for their business.
10 This evidence supports Ronnie Register's testimony that Barnett held himself out as an agent of the
11 original lender. As his testimony is credible that he disclosed the purchase of the Battle Ground house
12 to Barnett prior to preparing the June 2005 Financial Statement, there cannot be found an intent to
13 deceive, as actual disclosure is found to have been made.

14 It is probable that several misstatements made in the loan process originated with Barnett,
15 rather than the Debtors. For instance, Highline focuses on a fax memo from Gary Barnett to Steve
16 Sambor dated June 9, 2005, as evidence of the Debtors' intent to deceive. There is no persuasive
17 evidence, however, that the statements made by Barnett in this fax are true or originated with the
18 Debtors. For example, Barnett indicated that the Debtors were renting a home owned by Ronnie
19 Register's parents for \$500 dollars a month, but it is undisputed that the Debtors were living with
20 Carrie Register's parents and no rent was ever paid. Barnett also represented that Ronnie Register
21 would be receiving an inheritance within 30 days, while Ronnie Register testified that he informed
22 Barnett that the funds would be paid within six months to a year. Finally, Barnett apparently
23 unilaterally increased the amount of the loan to \$160,000, which the Debtors deny ever requesting.
24 The same is true of the typed February 5, 2005 Financial Statement. It is unrefuted that this statement
25 was prepared by Barnett. There is no explanation for the increase in funds held in checking accounts
on this statement by over \$50,000, and the Debtors deny ever making this representation or signing

1 this document. The similarities between the Debtors' signatures on this financial statement and the
2 handwritten one prepared by the Debtors, lend support to the Debtors' testimony that they did not sign
3 this document. Lastly, Barnett appears to have been subsequently dropped by Figaro's as a contact
4 for franchise lending due to similar disputes concerning inaccuracies, lending support to the Debtors'
5 testimony that it was not their intent to deceive.

6 As a final matter, also weighing against any intent to deceive based on the June 2005 Financial
7 Statement is the Debtors' testimony that they believed that their financing was approved in March of
8 2005. The Debtors' testified that Barnett informed them that the loan was approved based upon the
9 earlier financial statements. The Debtors' subsequent actions in purchasing equipment and entering
10 into a premises lease are consistent with this testimony.

11 Highline has failed to establish by a preponderance of the evidence intent to deceive on the
12 part of the Debtors based on the June 2005 Financial Statement.

13 B. Reliance on the Financial Statements


14 The Debtors contend that Highline has not established that it reasonably relied on alleged
15 misrepresentations in the June 2005 Financial Statement. The Court agrees.

16 As the Debtors are found to have disclosed their current income (in the Application for
17 Franchise Financing) and upcoming home purchase to the lender through Barnett, Highline cannot
18 establish that it relied on any misstatements regarding these facts in the June 2005 Financial
19 Statement.

20 Even if such information had not been disclosed, numerous "red flags" appear in this case that
21 should have alerted the lender that further investigation should have been conducted. See
22 BancBoston Mortgage Corp. v. Ledford (In re Ledford), 970 F.2d 1556, 1560 (6th Cir. 1992). Although
23 the reasonableness requirement is a fairly "low hurdle" for a creditor to meet in this circuit, a creditor is
24 not entitled to rely upon an obviously false representation. See, e.g. Deutsche Fin. Servs. Corp. v.
25 Osborne (In re Osborne), 257 B.R. 14, 21-22 (Bankr. C.D. Cal. 2000). Examples of such "red flags" in
this case are the asterisk appearing on the June 2005 Financial Statement after the \$280,000 without

1 further explanation; the blank appearing after the annual income section, which should have clarified
2 for what year the income was being stated; the complete lack of any expenses listed for mortgage or
3 rental payments; the lack of the disclosure of lease obligations when the lender was aware of the
4 nature of the proposed franchise and actively negotiated with the landlord concerning a waiver. Taken
5 together, these discrepancies would have alerted an ordinarily prudent lender to the possibility that the
6 representations were contradictory so that it could not reasonably rely on the representations made
7 without conducting at least some minimal investigation.

8 Based on the above, Highline has not established an intent to deceive or reasonable reliance.
9 Accordingly, Highline has not established each of the requisite elements for a finding of
10 nondischargeability under § 523(a)(2)(B).

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13 Paul B. Snyder
14 United States Bankruptcy Judge
15 (Dated as of Entered on Docket date above.)
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